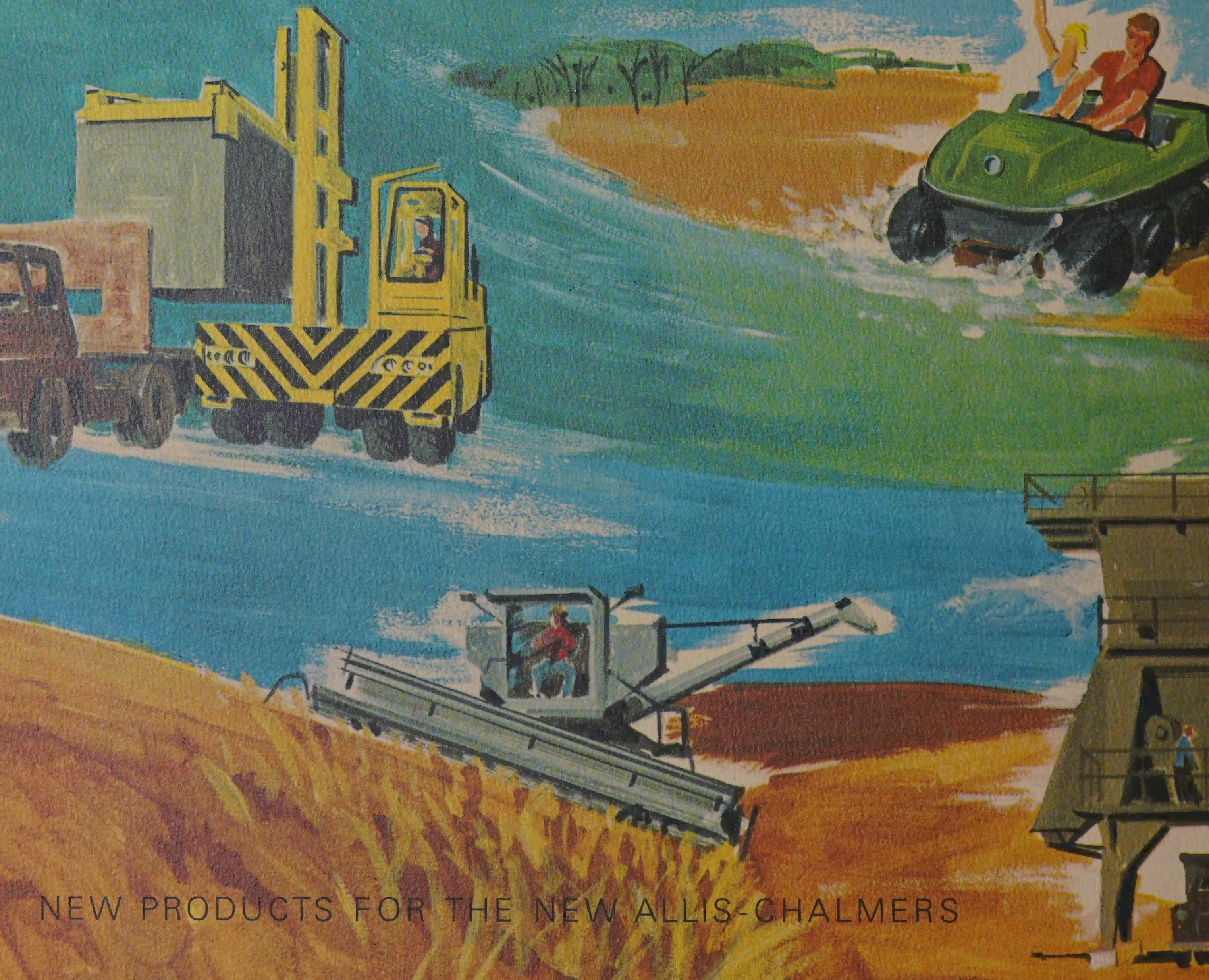
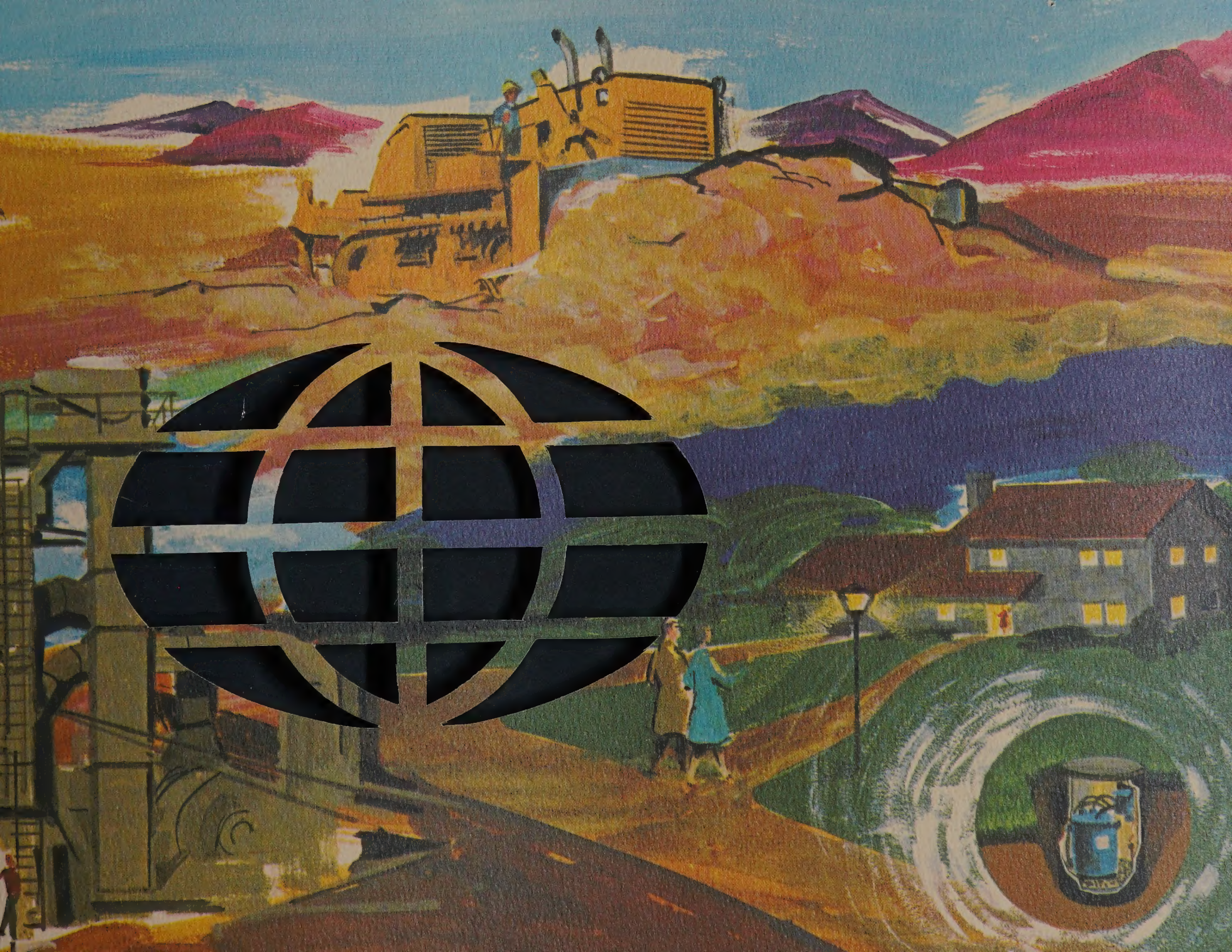
ALLIS-CHALMERS ANNUAL REPORT / 1968


NEW PRODUCTS FOR THE NEW ALLIS-CHALMERS



ALLIS-CHALMERS

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Directors and Officers . . . Inside Back Cover

GENERAL OFFICES • West Allis, Wisconsin

STOCK TRANSFER AGENTS • Morgan Guaranty Trust Company, New York, New York; Continental Illinois National Bank & Trust Company, Chicago, Illinois

ALLIS-CHALMERS / WORLDWIDE OPERATION

Allis-Chalmers, worldwide, is taking on a new dimension through acquisitions, joint ventures, construction of new facilities and the introduction of new products. Illustrated at upper left on the foldout is the Lancer Boss container handling sideloader from England. Next, in clockwise order, our *Terra Tiger* all-terrain vehicle. At upper right, the Allis-Chalmers HD-41 crawler tractor—30% larger than any bulldozer on the market today—will be distributed worldwide. In electrical equipment, new products including the *Sub/Tran* transformer (lower right) and agreements with overseas manufacturers expand our market position. The asphalt plant illustrated at lower center is one of a number of processing and construction products manufactured by our recently acquired subsidiary, Standard Steel Corporation. Our new *Gleaner* combines (lower left) are rated highest in efficiencies in harvesting jobs throughout the world.

SUMMARY	'68	'67
Sales	$767,313,100	$821,764,535
Net Income (Loss)	(54,589,720)	5,001,837
Per Share of Common Stock		
Net Income (Loss)	(5.26)	.41
Dividends	.62½	1.00
Book Value at Year-End	29.22	35.43
Additions to Plant & Equipment	30,407,000	37,243,000
Payrolls	266,244,643	270,343,388
At Year-End		
Working Capital	157,723,362	259,110,326
Current Asset Ratio	1.59 to 1	2.71 to 1
Common Share Owners	40,996	50,540
Employes—Worldwide	31,483	33,552

We began in September of 1968 to take decisive actions that will place this Company in the forefront of American industry. Included in these actions are steps to face financial reality, build a new management team, reorganize along decentralized lines, market new products and negotiate new ventures—all of which are described in this Annual Report, my first since joining Allis-Chalmers last September.

Sales totaled $767 million in 1968, compared with the Company's sales volume of $821 million in 1967. The net loss reported for 1968 is $54 million, divided into (1) $22 million from regular operations, (2) $19 million identified as unusual charges and reserves and (3) $13 million from extraordinary and nonrecurring charges. As explained in Note 6 to the financial statements, in 1968 the Company changed its method of computing depreciation and extended the application of tax allocation accounting procedures. These changes had the effect of reducing the net loss for the year by $8.9 million. In 1967, net income totaled $5 million.

Sales gains were recorded in 1968 in the three areas of electric utility products, engines and exports; but these were more than offset by lower sales levels in other divisions. I have stated before that Allis-Chalmers sales volume can reach $1.5 billion—double the present level—by 1974. This means, of course, that improvement begins in 1969.

Our 1968 operating results were adversely affected by reduced sales and extraordinary expenses involving costs and reserves related to closing down unprofitable plants for optimum utilization of manufacturing space and cutting out slow-moving inventory not associated with profitable product lines. Unusual charges and reserves make up "Operation Turnaround", our program started in late 1968 to restore profitability as soon as possible in all elements.

Other substantial charges were made for product and product line corrections. Finally, there were separation expenses and other costs and reserves associated with the reduction and relocation of nonproduction personnel and a restructuring of the Company's organization designed to provide greater profitability.

The charges to 1968 revenues are the result of major surgery that is absolutely necessary to free us from past fiscal and operating problems. Equally important are the corrective and constructive changes we have made throughout the Company.

On March 3, 1969, we announced that 450,000 shares of $100 par value convertible preferred stock were privately purchased by International Fiat Holding S.A., Switzerland, and certain Rocke-

feller interests. This $45 million of new capital reflects confidence in the ability of our new management team to turn this Company around and carry out our plans for profitable growth.

Effective March 3, 1969, Mr. R. S. Stevenson retired from the Company and resigned as Chairman of the Board. On the same date, Mr. A. D. Dennis, Vice President—Finance, Secretary and Treasurer, retired. Mr. C. J. Trone, Jr., has been elected the Company's chief financial officer. In the six month period beginning September 1, 1968, a total of 22 key personnel changes had been made in Allis-Chalmers top management.

ALLIS-CHALMERS PEOPLE / We have improved and will continue to improve the ratio of production and nonproduction employes. Allis-Chalmers has had far too many nonproduction employes in relation to production employes, an out-of-balance situation that is being corrected. Before year-end 1969, a total of 5,000 nonproduction personnel will have been released throughout the Company. Corporate staff employes—that is, people not reporting to profit centers—now total 132, a reduction of more than 1,300 from this classification in five months. Most of those formerly classified "corporate staff" have been transferred to profit centers. Others have left the Company, principally the result of normal attrition. Through more effective use of employe talents, we have reduced our worldwide employment since September 1968 by 2,250, or 7%.

Although decentralization moves were made some four years ago, operating divisions were not held to true profit responsibility. In addition to their own operating expenses, each producing division was charged with a proportionate amount of heavy corporate overhead expense. It is our intention to decentralize Allis-Chalmers fully into true profit centers, where each division and department general manager can be accurately measured on his performance of generating profit.

At present, our operations are structured into 30 profit centers, each properly sized and fully manageable, to bring about better control and profitability. This is more than twice the number of profit centers in September 1968. Today, our managers are able to direct their operations more effectively and focus properly on this profit responsibility.

For administration purposes, the 30 profit centers are assembled into seven operating groups, each one of which is headed by a senior vice president or vice president, who reports to the President.

Scheduled for completion in September, 1969, our Singapore parts depot and service training center will strengthen the Company's market position in the Asia and Oceania region.

MANUFACTURING EFFICIENCIES / I have strongly emphasized that Allis-Chalmers profit margins must be improved. To help accomplish this, our manufacturing breakeven points are being lowered through a program of rearrangement within plants, consolidation of facilities, abandonment of certain facilities and relocation from one site to another.

We look first at our Construction Machinery operations with its new top management. Manufacturing operations in five plants will be consolidated into two facilities fully capable of meeting current and projected product output, including the new HD-41 crawler tractor.

Decentralization for profit is our program. One integral part of that program is the move of industrial tractor and equipment headquarters from West Allis to our recently acquired subsidiary, Henry Corporation, Topeka, Kansas. Similarly, headquarters for the Company's Outdoor Products division have been moved to a new plant site in Lexington, South Carolina.

In Farm Machinery, two under-utilized plants will be combined into one. Before midyear we will begin to phase out the manufacturing operations at our La Crosse, Wisconsin, plant (tillage implements) and consolidate this product line into operations at our La Porte, Indiana, plant, where harvesting equipment is made. This move will help stabilize employment requirements and eliminate unnecessary overhead costs.

Further, an aggressive move to cut farm tractor manufacturing costs—and add to unit output—has been accomplished with the consolidation of three tractor assembly lines into a single, highly efficient production facility. Completed at our West Allis, Wisconsin, plant in December 1968, the new line can turn out 25% more large tractors than before, at lower unit cost.

Better utilization of machine tools and manufacturing space will be accomplished with the transfer of crusher, screen and certain other processing equipment production from West Allis to our Appleton, Wisconsin, plant. In addition, all standard pump manufacture will be concentrated at the Company's Norwood, Ohio, plant for greater efficiencies.

At West Allis, more emphasis will be placed on the design and manufacture of large-size specialty items for the Defense Department. At this location, our major machine tools are particularly suited for this type of custom machining and fabrication.

Our subsidiary, Canadian Allis-Chalmers, Ltd., will concentrate its operations at Lachine, Quebec, on the production and sale of

centrifugal pumps, pyro-processing and mining machinery for worldwide markets. Also, controls for diesel locomotives will continue to be produced at this site. In keeping with our plan to manufacture products in factories around the world that can best serve various markets, certain operations will be transferred from Canadian Allis-Chalmers. Hydraulic turbine design engineering and project management will move to our plant in York, Pennsylvania. Similarly, CA-C compressor and switchgear engineering will be transferred to our West Allis plant.

With concentration of manufacturing and true profit center responsibility through manageable division size, we have instituted better controls, new systems of quicker reaction times and lower costs—all designed to return Allis-Chalmers, in the shortest possible time, to a leading position in American industry.

NEW DIMENSIONS / Important developments in the new business area are bringing new dimensions to Allis-Chalmers, not only changing its present shape but providing opportunities for future worldwide development. In mid-1968, we reached an agreement with Siemens America, Inc., to install and service steam turbines and associated equipment manufactured by Siemens AG of Germany. This move expands the Company's extensive steam turbine-generator service operations.

To augment our existing line of material handling equipment, we have signed an agreement with the British firm of Lancer Boss, Ltd., producers of heavy duty fork lift trucks and specialized container handling equipment. Allis-Chalmers will market and eventually manufacture, in addition to its own line of lift trucks, 13 models of Boss engine powered lift trucks with lifting capacities from 8,000 to 100,000 lbs. In addition, we will market the 21 models that make up the Lancer line of container handling sideloaders, specially suited to the newest concepts in containerized shipping for air-freight, piggyback rail and ocean cargo. Although it is only 10 years old, the Lancer Boss firm already accounts for a substantial share of the world's production of sideloaders.

Our association with Lancer Boss is representative of the action being taken by your management to pursue worldwide opportunities and move this Company forward. It expands our sales potential in the areas of lumber, steel and concrete pipe, construction materials, railroads, airports, steel mills, seaports and heavy industry.

To extend our market penetration in another growth area, we

The Company's recently expanded line of mobile outdoor power equipment is manufactured in this new plant in Lexington, South Carolina.

acquired the assets of Standard Steel Corporation with headquarters in Los Angeles, California. Standard manufactures asphalt plants, fish meal plants, small kilns, rotary driers and coolers. This acquisition in January 1969, will add to our processing and construction machinery product lines. Standard Steel will operate as a wholly-owned subsidiary of Allis-Chalmers, with full profit center responsibility. The firm's plants are in Decatur, Illinois, and Los Angeles.

Three additional profit center divisions have been established in the Company's process industries area. This realignment was made in early 1969 to take full advantage of the Company's growth potential in specific markets. New divisions, in addition to Standard Steel, are (1) Aggregate and Coal Equipment, (2) Cement and Mining Systems and (3) Paper Machinery. Properly sized and structured, each division is fully responsible for the efficient and economic operation of its total business such as engineering, manufacturing, marketing, planning and all other functions performed within a profit center.

The restructuring of larger divisions into more manageable profit centers enables our general managers to react quickly to changing market conditions. As part of major steps toward accomplishing our profit goals, the Company's General Products division (mainly capital goods) has been divided into profit centers, similarly tailored to take full advantage of our growth potential.

Our former Electric Utility division, serving the electric power industry, has been reorganized into three profit centers. These are (1) Power Transmission, (2) Power Distribution and (3) Power Protection and Switching. Decentralization of authority and establishment of profit center responsibility are expected to improve sales volume and after-tax profit.

The new dimensions at Allis-Chalmers are part of my previously stated objectives to double sales and produce a 5½ to 6% net income on those sales in five years.

PRODUCT DEVELOPMENT / New products are being added to the Allis-Chalmers line through internal development as well as through agreements with—and acquisitions of—other companies. Our new giant HD-41 crawler tractor, powered by a 529-hp diesel engine, was introduced at CONEXPO '69, the huge construction machinery exposition held in Chicago in February 1969. Production of the HD-41—which is 30% larger than any bulldozer on the market today—will begin in 1970. Interest has been especially high in the unit's excellent production records on applications such as

strip mining, heavy road construction and reclamation projects. We expect the HD-41 to be an important addition to our construction machinery line.

The Company will begin to market an overseas manufactured farm tractor by mid-1969. This 40-hp unit, and our recently introduced 135-hp Model Two-Twenty, round out the Allis-Chalmers line of modern farm tractors.

Great emphasis is being placed on the development and addition of new, high-potential products. These include major home appliances, materials handling equipment, metal rolling mills and fuel cell power systems. Through our negotiations with overseas producers, we expect to be a substantial factor in the appliance business in 1969.

WORLDWIDE MARKETING / Our expansion into new markets is augmented by recent international developments. Two parts distribution and training centers—each of which will carry over 40,000 different spare parts items—are under construction in Liege, Belgium and in Singapore. Construction machinery, material handling, farm and industrial equipment parts dealers and customers located in Europe, North Africa, the Middle East, Asia and Oceania will obtain the latest in top-notch service and genuine parts delivery from these new facilities. A similar program is under way in South America with a new parts depot and distribution warehouse in Sao Paulo, Brazil, and a service training center in Recife, Brazil.

On the one hand, we have eliminated A-C's unprofitable product lines; on the other, we have added thrust in more promising lines to develop competitive advantages. One segment of the Company's product line receiving this new, added marketing emphasis is our engine line. Once a supplier of engines principally for Allis-Chalmers equipment, our Harvey, Illinois, engine division is aggressively making inroads in other markets. One of these penetrations is the market for diesel electric systems used in many military as well as commercial applications. Power protection applications, through the use of fully-integrated power packages, are becoming increasingly important. Also of significance, our engines are proving themselves to be efficient power plants in medium and large size on-highway trucks, a new market for our product.

Much of today's marketing involves sophisticated financing. This is particularly true when considering the variety of products Allis-Chalmers markets overseas. Here, we have the flexibility, size and capability to work out financings ranging from a fleet of 342

Our new Liege, Belgium, parts distribution and service training center will be servicing Allis-Chalmers dealers and customers in Europe, North Africa and the Middle East by late 1969.

harvesting machines for Pakistan to engineering contracts for the construction of huge pelletizing plants north of the Arctic Circle in Norway and Sweden.

International operations under new management showed considerable improvement in 1968. Export sales for the year were $80 million or 20% better than 1967. Overseas, major steps have been taken to improve manufacturing capabilities, distribution lines and marketing techniques to bring Allis-Chalmers closer to the customer.

RESEARCH AND THE FUTURE / One of our newest profit centers, the Advanced Electrochemical Products division, was formed in early 1968 to spearhead our formal thrust into the government high technology business. AEPD's major new products are fuel cell power systems and electrolysis equipment for life support in space and at ocean depths. Located at the Company's Greendale, Wisconsin, facilities, the division has been selected to produce fuel cells for NASA's Apollo Applications Program (AAP), the Air Force's Manned Orbiting Laboratory (MOL), and to make a design of fuel cell systems for the Navy's Deep Submergence Search Vehicle (DSSV).

These developments in the space and ocean exploration areas are examples of activities that make me enthusiastic about the potential and future of Allis-Chalmers, a major consideration in my joining the Company. We have made a lot of progress in just six months. The entire management team has been reorganized, re-staffed and trimmed down to provide clean, clear lines of responsibility and to focus sharply our talents on those areas of greatest potential. Current results have begun to reflect improvement as worldwide operations are brought increasingly under control. Allis-Chalmers is a new Company. We have taken the above described steps—and will take others—to place this Company, in the shortest possible time, in the category of "great" companies.

We do not anticipate any lag time. As of today, we have the capability and confidence to produce a significant profit.

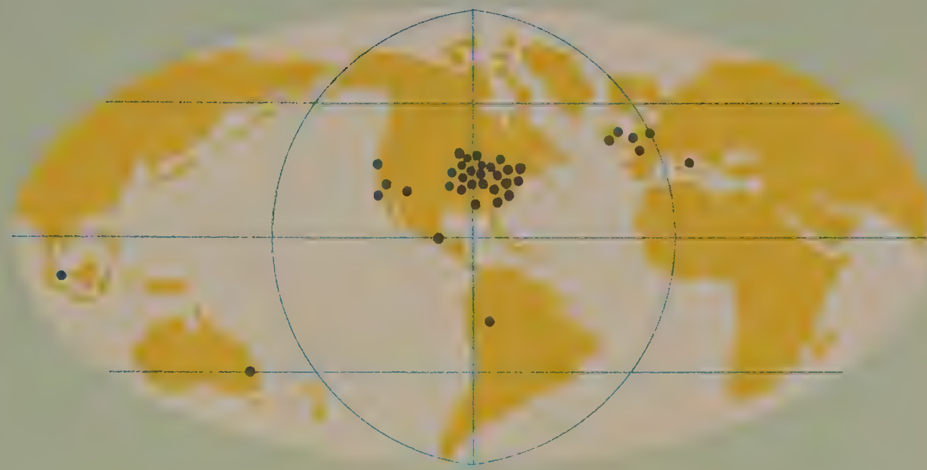
Respectfully submitted,

David C. Scott

David C. Scott

President and Chairman of the Board

March 15, 1969



WORLDWIDE OPERATING FACILITIES

Gadsden, Alabama / Phoenix, Arizona / Los Angeles, California / Oxnard, California / Carol Stream, Illinois / Decatur, Illinois Deerfield, Illinois / Harvey, Illinois / Springfield, Illinois / La Porte, Indiana / Cedar Rapids, Iowa / Topeka, Kansas / Boston, Massachusetts Independence, Missouri / New Brunswick, New Jersey / Norwood, Ohio / Portland, Oregon / Pittsburgh, Pennsylvania / York, Pennsylvania Lexington, South Carolina / Appleton, Wisconsin / Greendale, Wisconsin / La Crosse, Wisconsin / Port Washington, Wisconsin West Allis, Wisconsin / Newcastle, Australia / Liege, Belgium / Sao Paulo, Brazil / Guelph, Ontario, Canada / Lachine, Quebec, Canada / Toronto, Ontario, Canada / Essendine, England / Dieppe, France / Bremen, Germany / Milan, Italy / San Luis Potosi, Mexico / Singapore / Mold, North Wales

GENERAL MANAGERS

R. H. Brethen, *Outdoor Products* / W. F. Bueche, *Aggregate and Coal Equipment* / R. S. Burns, *Standard Steel Corporation* / J. H. Burrus, *Power Generation Installation and Service* / J. J. Chluski, *International* / W. H. Davis, *Hydraulic Products* / R. J. Dineen, *Motor and Generator* T. L. Dineen, *Process Equipment and Systems* / J. M. Duncan, *Paper Machinery* / R. L. Engel, *Farm Equipment* / C. F. Fowler, *Parts Central* Albert Henry, *Industrial Tractor* / Owen J. Higgins, *Material Handling* / George Hollins, *Engine* / Mitchell F. Keamy, Jr., *Cement and Mining Systems* / Ellward Laskin, *Power Distribution* / T. D. Lyons, *Electric Utility* / N. W. Morelli, *Power Transmission* / J. S. Morgan, *Power Protection and Switching* / D. J. Nairn, *Power Control Project* / H. C. Nickel, *Atomic Energy* / R. G. Nordstrom, *Industrial Machinery* Boyd S. Oberlink, *Canadian Allis-Chalmers* / J. L. Platner, *Advanced Electrochemical Products* / W. M. Schroeder, *Construction Machinery* T. J. Schuetz, *Defense Products* / W. L. Voegeli, *Simplicity Manufacturing* / R. G. Walker, *Control and Switchgear* / Frank Christensen, *Australia* Jean Joel Maunoury, *France* / Donald Wooley, *Great Britain* / Robert Wollberg, *Italy* / Alex Pastrana, *Mexico*

ASSETS / DECEMBER 31	1968	1967
Current Assets		
Cash	$ 23,483,905	$ 32,778,384
Receivables—less reserves of $16,171,800 and $12,990,000, respectively	126,836,883	125,835,967
Inventories—at lower of approximate cost (10% valued at LIFO) or market, less progress payments of $14,286,644 and $13,816,887, respectively	234,115,066	231,107,182
Income tax refunds and future income tax benefits (Note 3)	35,619,025	21,590,000
Other current assets	3,997,779	4,496,240
Total Current Assets	424,052,658	415,807,773
Estimated Future Income Tax Benefits (Note 3)	42,972,400	—
Investments and Other Assets		
Investment in finance subsidiaries—at equity in net assets	53,498,936	46,594,803
Investment in other subsidiaries—at cost, less reserves (Note 1)	18,524,117	23,748,137
Intangible assets arising from acquisition (Note 2)	7,389,935	7,389,935
Other investments, assets and deferred charges (Note 5)	6,366,775	5,244,786
	85,779,763	82,977,661
Plants and Equipment at cost		
Land and buildings	110,168,287	103,163,467
Machinery and equipment	190,005,484	180,635,390
Tools and fixtures	32,212,797	29,925,202
Furniture and fixtures	7,136,070	6,391,647
	339,522,638	320,115,706
Accumulated depreciation and amortization (Note 6)	186,714,838	178,989,166
	152,807,800	141,126,540
	$705,612,621	$639,911,974

LIABILITIES AND EQUITY / DECEMBER 31	1968	1967
Current Liabilities		
Notes payable and current maturities of long-term debt	$106,382,295	$ 50,797,500
Accounts payable and payrolls	68,970,051	69,978,681
Federal, state and Canadian income taxes	883,458	4,072,998
Reserves for completion of contracts and product corrections and current portion of special reserves	69,486,985	12,611,115
Other current liabilities	20,606,507	19,237,153
Total Current Liabilities	266,329,296	156,697,447
Special Reserves (Note 3)		
Estimated costs of parts replacement, warranty costs, repossession losses and price allowances	40,260,106	—
Estimated costs and losses associated with relocation and discontinuance of facilities and products	28,494,304	—
	68,754,410	—
Less amount included in current liabilities	48,000,000	—
	20,754,410	—
Long-Term Debt (Note 4)		
Notes payable	66,000,000	69,000,000
Sinking fund debentures	45,000,000	45,000,000
Other long-term debt	3,361,924	4,228,487
	114,361,924	118,228,487
Deferred Income Taxes	—	1,449,260
Share Owners' Equity (Notes 5 and 9)		
Preferred stock, $100 par value, 500,000 shares authorized, 134,594 shares, 4.20% cumulative convertible series outstanding in 1967	—	13,459,400
Common stock, $10 par value, 12,500,000 shares authorized, 10,410,292 and 9,881,481 shares outstanding after deducting 42,869 and 82,869 shares held in treasury, respectively	104,102,920	98,814,810
Capital in excess of par value of capital stock	122,548,752	113,198,182
Earnings retained	77,515,319	138,064,388
Total Share Owners' Equity	304,166,991	363,536,780
	$705,612,621	$639,911,974

1967 has been restated to conform with the current year's account classifications

STATEMENT OF INCOME (LOSS) AND EARNINGS RETAINED

Allis-Chalmers Manufacturing Company and Consolidated Subsidiaries

INCOME (LOSS) FOR THE YEAR / ENDED DECEMBER 31	1968	1967
Sales and Other Income		
Sales	$767,313,100	$821,764,535
Discounts, interest earned and other income	11,152,147	6,428,597
Income of finance subsidiaries	9,901,233	6,893,641
	788,366,480	835,086,773
Costs and Expenses		
Materials, plant payrolls and services (Note 3)	703,041,018	689,225,155
Depreciation (Note 6)	16,024,167	18,713,666
Selling, general and administrative expense (Note 3)	131,352,862	100,216,572
Discount and interest on receivables sold to finance subsidiaries	21,662,133	11,158,812
Other interest expense	9,380,927	9,590,531
	881,461,107	828,904,736
Income (Loss) before income taxes and extraordinary charges	(93,094,627)	6,182,037
Federal, state and Canadian income taxes (Notes 3 and 6)	51,942,000	(1,180,200)
Income (Loss) before extraordinary charges	(41,152,627)	5,001,837
Extraordinary charges—net of income taxes of $15,057,211 (Note 3)	(13,437,093)	—
Net Income (Loss) for the Year	$(54,589,720)	$ 5,001,837
Per average share of common stock—		
Income (Loss) before extraordinary charges	*$(3.96)*	*$.41*
Extraordinary charges, net of income taxes	*(1.30)*	—
Net Income (Loss) for the Year	*$(5.26)*	*$.41*
EARNINGS RETAINED AND USED IN THE BUSINESS		
Earnings Retained—Beginning of Year	$138,064,388	$143,681,336
Henry Manufacturing Company (Note 5)	493,260	—
Net Income (Loss) for the Year	(54,589,720)	5,001,837
	83,967,928	148,683,173
Dividends Paid		
Preferred stock—4.20% series	—	1,099,664
Common stock (per share: 1968—$.62½; 1967—$1.00)	6,452,609	9,519,121
	6,452,609	10,618,785
Earnings Retained—End of Year	$ 77,515,319	$138,064,388

1967 has been restated to conform with the current year's account classifications

NOTE 1—BASIS OF CONSOLIDATION / All domestic and Canadian subsidiaries, except finance subsidiaries and a marketing subsidiary, are included in the consolidated financial statements. The Company's investment in and advances to the unconsolidated foreign subsidiaries of $10,134,184, less reserve of $3,855,067, and the investment in and advances to the unconsolidated marketing subsidiary of $19,550,000, less reserve of $7,305,000, were approximately equal to the net assets of the respective subsidiaries at December 31, 1968. In addition, Allis-Chalmers International Finance Corporation, an unconsolidated finance subsidiary, has investments in and advances to unconsolidated foreign subsidiaries of $9,260,160 at December 31, 1968. (See page 19 for finance subsidiaries financial statements.)

NOTE 2—INTANGIBLE ASSETS ARISING FROM ACQUISITION / The excess of the purchase price over the value assigned to the assets acquired from Simplicity Manufacturing Company in October 1965 is not being amortized at present due to a suit brought by the Department of Justice contesting the acquisition. (See Note 8 to the financial statements.) Management believes that the asset is not diminishing in value and that the suit is without merit and will be successfully defended.

NOTE 3—SPECIAL RESERVES AND INCOME TAXES / During the last quarter of 1968 a major change took place in the Company's management. The new management made an extensive study of the Company's operations, products and markets. This study resulted in changes in Company philosophy and policies relating to organization, products and production facilities, marketing and relations with dealers and customers. The Company has estimated that implementation of these policy changes will result in substantial costs and losses for (a) parts replacement, warranty costs, repossession losses and price allowances and (b) relocation and discontinuance of facilities and products. Provisions were recorded in the last quarter of 1968 to establish special reserves totaling $68,754,410 for these anticipated costs and losses. Of this amount, $28,494,304 ($13,437,093 net of taxes), associated with relocation and discontinuance of products and facilities, is shown as an extraordinary charge in the consolidated statement of income (loss). The remaining provisions, totaling $40,260,106, were charged to sales ($5,627,178), materials, plant payroll and services ($28,190,928) and selling, general and administrative expenses ($6,442,000).

Although the costs and losses to be charged to the special reserves cannot be finally determined at the present time, management believes, based on the Company's extensive studies and evaluations which were reviewed in depth by the independent auditors, that the provisions recorded in 1968 represent a fair and reasonable determination of the amounts required.

The net loss for the year has been determined after giving recognition to income taxes recoverable ($14,345,721) from carryback to prior years of operating losses and to estimated future tax benefits ($50,900,000) of unused losses, including $6,836,276 relating to an accounting change described in Note 6 to the financial statements. The amounts recoverable from carryback to prior years are included in current assets in the consolidated balance sheet together with 1968 tax refunds receivable of $3,970,000 and estimated future income tax benefits of $17,303,304 relating primarily to normal book-tax timing differences applicable to amounts included in current assets and liabilities. The realization of estimated future income tax benefits which total $60,275,704 is dependent upon the Company's ability to generate future taxable income. This amount is included in the financial statements because, in the opinion of management, the realization of such tax benefits is assured beyond any reasonable doubt.

The Company has unrecorded investment tax credit carryforwards of $6,098,722, applicable to the years 1962 through 1968, which may be used to reduce income taxes payable in future years.

NOTE 4—LONG-TERM DEBT / Notes payable at December 31, 1968, consisted of $55,000,000 3⅝% notes and $11,000,000 3⅞% notes, all payable to insurance companies, due $3,000,000 annually, maturing in 1982. The sinking fund debentures of $45,000,000, due in 1990, bear interest at 4.85%. The debentures are entitled to a mandatory sinking fund commencing in 1971 sufficient to retire 76% of the debentures prior to maturity ($1,800,000 per year). Other long-term debt consists of (a) capitalized lease obligations of $2,200,000, (b) antitrust claim settlements of $904,479, and (c) mortgage notes payable by a subsidiary company of $257,445.

NOTE 5—SHARE OWNERS' EQUITY AND DIVIDEND RESTRICTIONS / During 1968, the remaining 134,594 shares of the 4.20% convertible preferred stock were converted into 442,621 shares of common stock or were redeemed, 46,190 shares of common stock were issued to acquire the net assets of Henry Manufacturing Company and 40,000 shares of common stock held in the treasury were sold. These transactions are summarized as follows:

	Common Stock	Capital in Excess of Par Value
Balance at beginning of year	$ 98,814,810	$113,198,182
Conversion of preferred stock	4,426,210	8,850,681
Acquisition of Henry Manufacturing Company	461,900	(135,111)
Sale of treasury shares	400,000	635,000
Balance at end of year	$104,102,920	$122,548,752

The acquisition of Henry was a pooling of interests and their accounts have been included in the consolidated financial statements for 1968. The consolidated financial statements for 1967 were not restated because of the relative immateriality of the amounts involved.

Other non-current assets include a note receivable from the president of the Company of $1,035,000, relating to the sale of treasury stock, which is payable on March 4, 1974, with interest at a rate of 5%. The note is secured by a pledge and assignment of the common stock.

Agreements relating to debentures and notes payable and the certificate of incorporation contain certain restrictions relating to the declaration of cash dividends. Under these restrictions the entire amount of earnings retained at December 31, 1968, was not available for the future declaration of cash dividends on the common stock. The required increase in equity before any such amounts become available for dividends was approximately $29,000,000 at December 31, 1968. The issuance and sale of capital stock described in Note 9 to the financial statements will have the effect of making available earnings retained for declaration of cash dividends of approximately $6,000,000, subject to earnings of the Company subsequent to 1968.

NOTE 6—ACCOUNTING CHANGES / The Company has adopted, for financial reporting purposes, the straight-line method of computing depreciation for sub-

stantially all plants and equipment. These fixed assets were previously depreciated on an accelerated basis. This change, effective January 1, 1968, reduced depreciation expense by $4,505,109 and decreased the net loss by $2,126,411, equal to $.21 per common share.

In 1968, the Company extended the application of tax allocation accounting procedures to certain reserve accounts to comply fully with new tax accounting requirements effective this year. The extension of these procedures decreased the net loss by $6,836,276, equal to $.66 per common share.

NOTE 7—PENSION PLANS / The Company and its consolidated subsidiaries have several noncontributory retirement and pension plans covering substantially all of their employes. The total pension expense charged to income was $20,866,000 in 1968 and $17,230,000 in 1967; these amounts include amortization of prior service cost of the principal hourly plans over a 30-year period. The Company's policy is to fund pension cost accrued. The actuarially computed value of vested benefits for all plans exceeded the total of the pension funds and balance sheet accruals by approximately $79,000,000 at the 1968 plan valuation dates.

NOTE 8—COMMITMENTS AND CONTINGENCIES / Litigation in which the Company is involved is summarized below:

(a) An action started in the U.S. District Court for the District of Delaware by the Company against White Consolidated Industries, Inc. in December 1968, under Section 7 of the Clayton Act, to enjoin White from, among other things, attempting to obtain control over the Company through the acquisition by White of 3,248,000 shares of the Company's common stock from Gulf & Western Industries, Inc. and to compel divestiture of this holding on terms that would not be injurious to the Company. Denial of a motion by the Company for a preliminary injunction enjoining White from acquiring additional stock and attempting to obtain control pending the outcome of the suit has been appealed to the U.S. Court of Appeals.

(b) An action started by the Company against Gulf & Western Industries, Inc. in January 1969, under Section 16(b) of the Securities and Exchange Act of 1934, to recover "short-swing profits" realized by Gulf & Western from its sale of 3,248,000 shares of the Company's common stock to White Consolidated Industries, Inc. Gulf & Western has filed a cross complaint seeking exemption from the provision of such Act on the ground that it was obliged to sell such stock under duress.

(c) An action started by the Department of Justice against the Company in 1965, under Section 7 of the Clayton Act, to obtain injunctive relief and an order of divestiture arising out of the Company's acquisition of the assets of Simplicity Manufacturing Company. Trial of this action was closed in November 1968, and briefs and proposed findings are to be filed by September 1969.

(d) An action brought against the Company by White Consolidated Industries, Inc. in February 1969, to obtain rescission of an acquisition agreement between the Company and Standard Steel Corporation, damages and injunctive relief to prohibit the Company from taking any steps, by acquisition or otherwise, which would have the effect of unreasonably diluting the voting equity of White in the Company. Action is pending the filing of pleadings or motions by the Company.

There are various other lawsuits pending against the Company, arising in the normal course of business. Management believes, based on the opinion of legal counsel, that disposition of these actions will not have a significant adverse effect on the Company's financial position.

The Company has guaranteed payment of the $15,000,000 of 6⅝% notes payable of its wholly-owned subsidiary, Allis-Chalmers International Finance Corporation and of approximately $7,000,000 of short-term bank borrowings of foreign subsidiaries.

Under certain circumstances, the Company is obligated to repurchase delinquent financing paper sold to its finance subsidiaries. The repurchase price is generally the net carrying value of the paper at time of repurchase, or if there is no recourse to a solvent dealer, the estimated market value of the machinery.

Annual rental commitments under long-term leases, which expire at various periods through 1991, amounted to approximately $700,000 at December 31, 1968.

NOTE 9—EVENTS SUBSEQUENT TO DECEMBER 31, 1968 / See Note 8 to the financial statements for comments on litigation developments in 1969.

On January 13, 1969, the Company issued 280,000 shares of its common stock in exchange for the net assets of Standard Steel Corporation in a transaction which will be accounted for as a pooling of interests. The accounts of Standard Steel for 1968 are not material in relation to the consolidated accounts. Standard's sales for the year ended December 31, 1968, amounted to $12,000,000.

On March 3, 1969, the Company sold to private investors 450,000 shares of 4% $100 par value cumulative convertible preferred stock. The net proceeds to the Company were $45,000,000, less expenses. Each share of the preferred stock is convertible into four shares of common stock and is entitled to the same number of votes as the common stock into which it is convertible. The preferred stock is redeemable at $104 per share. In connection with the sale of the preferred stock, the Company returned to authorized but unissued stock 33,161 shares of treasury common stock, and reserved 1,800,000 of authorized but unissued shares of common stock for issuance upon conversion of the 450,000 shares of preferred stock.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors of
Allis-Chalmers Manufacturing Company

We have examined the consolidated statement of financial condition of Allis-Chalmers Manufacturing Company as of December 31, 1968 and the related statement of consolidated income (loss) and earnings retained for the year. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As explained in Note 3 to the financial statements, in the last quarter of 1968 the Company recorded substantial amounts associated with (a) reserves for anticipated costs and losses, and (b) estimated income tax benefits expected to be realized in the future. Although these reserves and anticipated tax benefits reflect the best current judgment of the Company's management, we cannot determine at this time the amounts of costs and losses which ultimately will be charged against the reserves, and the amounts of future tax benefits which ultimately will be realized.

In our opinion, subject to the effect of any adjustments which may result from ultimate determination of the matters referred to in the preceding paragraph, the accompanying consolidated financial statements examined by us present fairly the financial position of Allis-Chalmers Manufacturing Company and its subsidiaries at December 31, 1968 and the results of their operations for the year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year, except for the changes in accounting for depreciation and income taxes as explained in Note 6 to the financial statements.

Milwaukee, Wisconsin
March 26, 1969

PRICE WATERHOUSE & CO.

Combined Financial Statements

STATEMENT OF FINANCIAL CONDITION / DECEMBER 31	1968	1967
ASSETS		
Cash	$ 21,696,063	$ 17,091,441
Receivables—		
Notes and installment contracts from customers and dealers (Note 1)	188,355,966	170,144,331
Floor plan contracts	174,536,161	185,762,591
Less: Reserve for possible losses	(1,000,000)	(1,000,000)
Unearned discount, finance charges and rentals	(36,865,799)	(30,785,140)
Net receivables	325,026,328	324,121,782
Leasehold machinery, less depreciation of $3,500,337 and $2,926,352, respectively	9,836,379	10,082,543
Investments in and advances to foreign subsidiaries of Allis-Chalmers Manufacturing Company	9,260,160	6,361,840
Receivable from Allis-Chalmers Manufacturing Company	1,225,453	5,024,417
Other assets, accrued interest receivable and deferred charges	4,876,511	3,973,382
	$371,920,894	$366,655,405
LIABILITIES AND EQUITY		
Notes payable—short term	$184,299,667	$185,800,772
Other payables and taxes	4,122,291	4,259,830
Term notes to insurance companies (Note 2)	115,000,000	115,000,000
6⅝% Notes payable—guaranteed (Note 2)	15,000,000	15,000,000
5¼% Junior subordinated notes to parent company, due 1988	10,000,000	10,000,000
Capital stock (Note 3)	25,200,000	23,200,000
Earnings retained	18,298,936	13,394,803
	$371,920,894	$366,655,405

STATEMENT OF INCOME AND EARNINGS RETAINED	1968	1967
Income from financing operations	$ 35,652,164	$ 25,391,237
Interest expense	19,680,927	13,720,890
Operating expenses	6,070,004	4,776,706
Federal and state income taxes (Note 4)	4,997,100	3,400,200
	30,748,031	21,897,796
Net Income for the Year	4,904,133	3,493,441
Earnings Retained—Beginning of Year	13,394,803	9,901,362
Earnings Retained—End of Year	$ 18,298,936	$ 13,394,803

1967 has been restated to conform with the current year's account classifications

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 1—NOTES AND INSTALLMENT CONTRACTS / Notes and installment contracts receivable at December 31, 1968, include $166,303,037 of retail receivables and $22,052,929 due from dealers, principally for the financing of rental equipment. Note and contract installments, which by their terms are collectible after one year, amounted to $106,092,000 at December 31, 1968.

NOTE 2—NOTES PAYABLE / Term notes payable to insurance companies, at December 31, 1968, consisted of (a) $30,000,000 4⅞% senior notes and $10,000,000 5¼% senior subordinated notes, due $1,000,000 annually commencing in 1969 with final maturity in 1983; (b) $25,000,000 5¼% senior notes and $10,000,000 5½% senior subordinated notes, due $880,000 annually commencing in 1971 with final maturity in 1985; and (c) $30,000,000 6⅜% senior notes and $10,000,000 6¾% senior subordinated notes, due $1,000,000 annually commencing in 1973 with final maturity in 1987.

The 6⅝% notes payable guaranteed by the parent company mature in 1972 and are redeemable in whole or in part, at the option of the subsidiary company, at fixed redemption prices plus accrued interest, beginning February 1, 1970.

NOTE 3—CAPITAL STOCK / During 1968 the parent company increased its investment in the capital stock of Allis-Chalmers Credit Corporation by $2,000,000.

NOTE 4—FEDERAL INCOME TAXES / The combined income and expenses of the finance subsidiaries will be included in the 1968 consolidated federal income tax return of the parent company. No federal tax will be payable because of a consolidated net operating loss; however, a provision in lieu of taxes of $4,498,300, which approximates the federal taxes that would have been payable on a separate company basis, has been made and credited to the parent company.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors of
Allis-Chalmers Manufacturing Company

In our opinion, the accompanying combined statement of financial condition and the related combined statement of income and earnings retained present fairly the combined financial position of Allis-Chalmers Credit, Leasing and International Finance Corporations at December 31, 1968 and the combined results of their operations for the year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Our examination of these statements was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Milwaukee, Wisconsin
March 26, 1969

PRICE WATERHOUSE & CO.

10 YEAR SUMMARY

	YEAR ENDED DECEMBER 31 /	1968	1967	1966	1965	1964	1963	1962	1961	1960	1959
In Thousands of Dollars	Sales	767,313	821,764	857,215	714,408	629,067	543,941	516,093	502,243	530,019	539,640
	Income (Loss) Before Extraordinary Charges	(41,152)	5,001	26,154	22,109	12,739	6,870	6,478	6,384	10,999	23,091
	Extraordinary Charges, Net of Tax	(13,437)	—	—	—	(21,060)	—	(16,466)	—	—	—
	Net Income (Loss)	(54,589)	5,001	26,154	22,109	(8,321)	6,870	(9,988)	6,384	10,999	23,091
	Dividends Paid—Common Stock	6,453	9,519	7,592	5,065	4,488	4,444	6,812	11,376	13,651	11,102
	Dividends Paid—Preferred Stock	—	1,099	1,304	1,099	385	385	385	385	386	418
In Dollars per Share of Common Stock	Income (Loss) Before Extraordinary Charges	(3.96)	.41	2.67	2.33	1.38	.73	.67	.66	1.17	2.58
	Extraordinary Charges, Net of Tax	(1.30)	—	—	—	(2.35)	—	(1.81)	—	—	—
	Net Income (Loss)	(5.26)	.41	2.67	2.33	(.97)	.73	(1.14)	.66	1.17	2.58
	Dividends	.62½	1.00	.81¼	.56¼	.50	.50	.75	1.25	1.50	1.25
	Book Value	29.22	35.43	36.34	34.68	32.98	34.68	34.37	35.94	36.53	36.88
In Thousands of Dollars	Net Assets	304,167	363,536	368,939	351,772	306,481	317,866	317,283	336,563	341,940	344,979
	Long-Term Debt	114,362	118,288	125,577	130,288	87,163	82,465	86,135	89,805	93,475	94,145
	Plants and Equipment (Gross)	339,523	320,115	295,364	294,874	286,580	278,862	271,031	255,632	239,542	230,027
At Year-End	Employes—Worldwide	31,483	33,552	38,633	35,249	34,259	33,552	32,897	30,216	32,173	36,130
	Shares Outstanding—Common Stock	10,410,292	9,881,481	9,370,543	9,006,430	9,005,763	8,893,263	8,956,982	9,101,381	9,101,381	9,089,535
	Shares Outstanding—Preferred Stock	—	134,594	284,090	394,216	94,416	94,416	94,416	94,416	94,416	97,968
	Share Owners of Common Stock	40,996	50,540	59,941	54,707	58,679	61,266	65,977	67,997	67,495	62,414

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John M. Coates

G. O. Haglund

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